ShareAction
the movement for Responsible Investment

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Public consultation on the operations of the European Supervisory Authorities - May 2017

ShareAction is a UK registered charity established to promote transparency and Responsible Investment practices by pension funds and other institutional investors. As well as working in the UK, we coordinate the European Responsible Investment Network and engage with European policymakers through our Brussels-based work. We are a member organization and count amongst our members well-known NGOs and charitable foundations, as well as over 35,000 individual supporters.

Since 2007, ShareAction have a solid history of conducting benchmarking surveys on Responsible Investment (RI) practices within the investment industry. Our newly published 2016/17 report 'Lifting the Lid: Responsible Investment Performance of European Asset Managers' covers 10 different European countries with the examination and ranking of the transparency and Responsible Investment (RI) practices of 40 of the largest asset managers in Europe.

These surveys remain the only independent benchmark of the asset management industry's RI performance covering issues such as integration of environmental, social and governance (ESG) factors into investment processes, stewardship of companies, shareholder voting and transparency and reporting.

The centrality of the ESAs in fostering responsible investment

The chance to respond to the public consultation to the ESAs comes at a very opportune and significant time in European financial regulation. The European Commission's flagship initiative, the Capital Markets Union (CMU), is considered a central tenet of the European financial system and expected to deliver jobs and growth. Conversely, the creation of the High Level Expert Group on Sustainable Finance (HLEG) is an indication of the increasing role for sustainability within the same financial ecosystem, implying that the narrative of jobs and growth is one that must be coupled with a fair consideration of sustainability. This sentiment is reflected in the European Commission's Communication 739, "Next steps for a sustainable European future", which recognizes the Capital Markets Union as a vehicle through which to achieve "a deeper and fairer internal market with a strengthened Industrial base" through a "new and forward looking approach to ensure sustainable finance is taken forward". As such, we consider that the ESAs should be informed by the same narrative and seek to reflect the aforementioned connection.

In the recent Hearing on the Midterm Review of the Capital Markets Union, HLEG Chairman Christian Thimann made a significant comment on the purpose of sustainability. Sustainability is comprised of but not simply limited to considerations surrounding one its central tenets, the integration of ESG (environmental, social and governance) factors in investment decision-making, but should also be viewed as central to a resilient financial system that can effectively respond to risk and deliver long-term protection to retail investors and consumers. In this sense, we consider that the remit of the ESAs is not separate from the need to create a financial system rooted in sustainability – this work is crucial in ensuring investor protection from systemic risk and the centrality of the interests of the European saver, whose money underpins the functioning of capital markets.

We strongly believe that the centrality of the stimulation of investment within the CMU should be tempered by a significant caveat: investment as an end in and of itself does not always make financial sense, nor lead to the right kind of growth. This idea was proposed by the OECD's 2015 Revision of its Policy Framework for Investment, which clearly states:

> *"…some sectors and economies at certain points in time may suffer from a surfeit of investment, excess capacity and wasted resources. Investment might also flow into sectors which do not provide sufficient productive or social benefits or which cause environmental degradation. The growth and development impact of investment will depend as much if not more on the quality of investment as it does on the quantity"*[1].

ShareAction welcomes the opportunity to respond to this consultation and we believe that the ESAs are a central component for creating a strong, resilient and sustainable European financial system, rooted in quality investment that can deliver real results in reducing risk through the mitigation of social and environmental dangers posed by loopholes in financial regulation. This is truly the only framework which can guarantee the long-term protection of the average European saver as retail investor and consumer.

I. Tasks and powers of the ESAs

A. Optimizing existing tasks and powers

I. A. 1. Supervisory convergence

Question 1: In general, how do you assess the work carried out by the ESAs so far in promoting a common supervisory culture and fostering supervisory convergence, and how could any weaknesses be addressed?

The importance of supervisory convergence cannot be understated in the lead-up to planning for financial services regulation in the post-Brexit world. The political uncertainty currently framing the Brexit negotiations obscures the form that this regulation will take, but one obvious danger remains clear: the possibility of a destabilizing and detrimental race to the bottom, created by deregulation and changes in taxation regimes in both the UK and the EU27[2]. This practice could risk creating a financial system unable to deliver on the basic environmental and social concerns that matter to ordinary European citizens and which would also protect them as consumers and investors. For example, growing evidence suggests that climate change, poses important implication for financial stability, which would have a direct impact on investor and consumer protection[3]. As such, we believe that the fostering of a common supervisory culture and convergence is key in ensuring one piece of the puzzle of strong consumer and investor protection: sustainability. We encourage the ESAs to vigorously engage in their supervisory convergence work and to view this work as intimately connected not just to financial stability, but to environmental and social governance and the protection of the ordinary European as retail investor. This work should be reinvigorated in the context of Brexit.

I. A. 3. Consumer and investor protection

Question 7: What are the possible fields of activity, not yet dealt with by ESAs, in which the ESA's involvement could be beneficial for consumer protection?

In the aftermath of the adoption of IORPS II, we encourage EIOPA to further its work on clarifying guidance in the area of fiduciary duty, primarily with a focus on clarifying the

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[1] See OECD, "Policy Framework for Investment: 2015 Edition".
[2] See Anneliese Dodds, "Brexit: A New Deal for Financial Services", January 2017.
[3] See Maria J. Nieto, "Bank and Environmental Sustainability: Some reflections from the perspective of financial stability", Centre for European Policy Studies, No 2017/01, May 2017.

concept of fiduciary duty across the EU27, as well as clarifying responsibilities of fiduciaries in integrating ESG (environmental, social, governance) factors[4]. Such guidance should be integrated in the transposition process of IORPS II and be specifically tailored to Member State regulators. The furtherance of work on fiduciary duty is crucial in the development of a strong system of protection for retail investors, a sentiment reflected by Gabriel Bernadino, Chairman of EIOPA, in the Hearing on the Midterm Review of the Capital Markets Union on April 11th, 2017 .Additionally, we call for ESMA to provide guidelines or an opinion on the reporting requirements outlined in the Non-Financial Reporting Directive, with a particular emphasis on ensuring that financial and extra-financial information be released in concurrent reports, in order to emphasize the financial materiality of diversity and other information (we consider the term “non-financial” to be a misnomer).We believe that these guidelines should integrate the work begun by the Task Force on Climate-Related Financial Disclosures (TCFD) and leave room for future reflection on their link to social and governance factors. This is in line with the understanding of climate-related risks as systemic, making their mitigation a crucial component of responsible risk management and consumer protection. We note the significant work already started in this field in “Resource Efficiency and Fiduciary Duties of Investors” by DG ENV and “Fiduciary Duty in the 21st Century” by PRI et al. Finally, we believe that Credit Rating Agencies are a critical component in the creation of a truly sustainable financial system. As such, we encourage ESMA, as the agencies' direct supervisor, to provide clear guidelines on how ESG-related factors can be integrated into their functioning.

C. Direct supervisory powers in certain segments of capital markets

Question 19: In what areas of financial services should an extension of ESMA’s direct supervisory powers be considered in order to reap the full benefits of a CMU?

We note the centrality of convergent supervisory approaches as central in the development of deeper and more integrated capital markets, a goal in line with the Commission Communication on Capital Markets Union - Accelerating Reform. We believe that a key component necessary to ensure that the CMU functions for the best interest of retail investors, whose money underpins European capital markets, is to ensure that this supervisory convergence expands to issues of sustainable finance and responsible investment. The stated purposes of the CMU can only be sustainably reached when systemic risk related to sustainability is dealt with effectively, ensuring the long-term protection of retail investors.[5]

Question 20: For each of the areas referred to in response to the previous question, what are the possible advantages and disadvantages?

The advantages of expanding the supervisory powers of the ESMAs to sustainable finance and responsible investment are plentiful, led by the creation of sustainable and resilient capital markets that work hand in hand with investor protection. The increased role of retail investors in spearheading growth in the European Union through the CMU needs to be accompanied by a framework that ensures that their interests and investments are protected. Setting the framework for a sustainable investment system is a prime way of ensuring that retail investors will be able to reap the benefits of capital markets in the long-term, through sustainable, responsible growth and job creation.

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[4] According to the Commission “Sustainable investment is broadly understood as encompassing environment, social and governance considerations in the investment process.” HLEG official minutes.

[5] See, Ingrid Holmes “Future-proofing the Capital Markets Union”, Briefing paper, October 2015.

A possible disadvantage is the cultural and regulatory dissonance concerning sustainability in different member states, which may make it difficult for these principles to function holistically and uniformly. However, this solution to this disadvantage lies in by the implementation of our recommendation, as ESMA's guidance can help create the regulatory culture needed for sustainable capital markets to reach scale.

B. Stakeholder groups

Question 26: To what extent are the provisions in the ESA Regulations appropriate for stakeholder groups to be effective? How could the current practices and provisions be improved to address any weaknesses?

Specialized stakeholder groups are a key tool in ensuring that the ESAs are responsive and reactive to the feedback of different societal groups, ensuring a holistic approach to strong consumer and investor protection, as well as risk management. We reiterate the need for these groups to be composed by diverse stakeholders, including industry, consumer groups and civil society representatives, as well as to ensure equal participation, access and influence of different stakeholders in the policy-making process.

General question

Question 32: You are invited to make additional comments on the ESAs Regulation if you consider that some areas have not been covered above.

Related to Q19, but not simply significant within the context of the CMU, is the release of guidelines clarifying the content and applicability of ESG (environmental, social and governance) factors, which, according to the Commission, is a central component of responsible investment.